FILE COPY

No. 49

In the Supreme Court of the United States

October Term, 1942

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner

v.

R. Douglas Stuart

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

INDEX

CITATIONS

486009—42——1

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

R. DOUGLAS STUART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 26-37) is reported in 42 B. T. A. 1421. The opinion of the Circuit Court of Appeals (R. 46-57) is reported in 124 F. (2d) 772.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 19, 1941. (R. 57.) The petition for a writ of certiorari was filed March 19, 1942, and was granted April 27, 1942. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer established four trusts, one for the support and benefit of each of his four children, all of whom were minors during the taxable periods here involved, naming himself, his wife, and his brother as trustees. The corpus of each trust consisted of shares of stock in a corporation of which the taxpayer was first vice president and his brother was president. The grantor reserved the right to direct the trustees with respect to sales and reinvestments of trust property. During the grantor's life, his wife and brother were empowered to change the beneficiaries of the trusts and to amend the indentures in any respect. Is the grantor accountable under Sections 166, 167, or 22 (a) of the Revenue Act of 1934 for the income of these trusts?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix to the Commissioner's brief in *Helvering* v. *John Stuart*, No. 48, present Term, a companion case to be argued immediately preceding the instant one.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 27–30) may be summarized as follows:

Taxpayer and his wife, Harriet McClure Stuart, have four children: Robert, born April 26, 1916; Anne, born January 11, 1920; Margaret, born

January 3, 1922; and Harriet, born February 3, 1928 (R. 27).

On March 25, 1932, taxpayer created four separate trusts, one for the benefit of each of his four children. In the trust indentures taxpayer named himself, his wife, and his brother, John Stuart, as the trustees of each trust. To the trustees of each trust taxpayer transferred 1,500 shares of the common stock of the Quaker Oats Company of which he was first vice president (R. 27).

The provisions of each of the four trust indentures were substantially the same. Until the child designated as the beneficiary of the particular trust became 30 years of age (25 years of age in the case of the trust for taxpayer's son), the trustees were to pay over to the beneficiary, or were to apply for the beneficiary's education, support, and maintenance, so much of the net income of the trust as seemed advisable to the trustees, and were to add the unexpended portion of the net income of the trust to the principal of the trust. When the beneficiary became 30 years of age (25 years of age in the case of the trust for taxpayer's son), the trustees were to pay over to the beneficiary one-half of the principal of the trust. Thereafter, the trustees were to pay over to the beneficiary the net income from the remaining one-half of the principal of the trust until the beneficiary became 35 years of age (30 years of age in the case of the trust for taxpay-

er's son), when the trustees were to pay over to the beneficiary the remaining one-half of the principal of the trust (R. 27).

In the event of the beneficiary's death before receiving all of the principal of the trust, the trustees were to pay over the remaining principal to the beneficiary's children; or, if the beneficiary left no children surviving, to taxpayer's issue then surviving; or, if the beneficiary left no children surviving and there were then surviving no issue of taxpayer, to Princeton University and the Presbyterian Hospital of the city of Chicago in equal shares (R. 27).

The trustees were empowered to collect all income; to sell any of the securities held in trust; to invest the proceeds from the sale of securities and the net income added to trust principal in income producing property or securities, real or personal, without being restricted to investments as fixed by the statutes of Illinois; to execute all necessary assignments and other instruments; to exercise the voting power upon all shares of stock held in trust; to exercise every power and do every act and thing in respect of any shares of stocks and bonds which they could or might do if they were absolute owners thereof; to unite with others in carrying out any plan for the reorganization of any corporation the securities of which were held in trust; to exchange the securities of any corporation for other corporate securities;

to assent to the consolidation or merger of any corporation; to pay assessments and expenses for the protection of the interest of the trust in the securities of any corporation; and to employ agents and attorneys (R. 28).

Stock dividends, liquidating dividends, and proceeds from the sale of any part of the trust fund, including profits, were to constitute principal (R. 28).

Each trust indenture contained a clause providing that the trustees were not to incur any liability except such as might be due to actual fraud or willful mismanagement, and a clause providing that any person dealing with the trustees was not to be required to see to the application of any money paid to the trustees (R. 28).

Paragraphs eighth and ninth of each trust indenture provided as follows (R. 28–29):

> Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

> Ninth. During the life of the Donor, the said Harriet McClure Stuart and the said John Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect.

On August 2, 1935, taxpayer's wife and brother executed an amendment to each of the four trust indentures, canceling paragraph eighth and changing paragraph ninth to read as follows (R. 29):

> Ninth. This Indenture and all the provisions thereof are irrevocable and not subject to alteration, change or amendment.

During the period from March 25, 1932, to August 2, 1935, no changes were made in the beneficiaries of the four trusts or in the property held by the trusts. (R. 29.)

On the fiduciary income tax returns filed by the trustees of the four trusts for the years 1934 and 1935 the net income of each of the trusts was reported as follows (R. 29):

Trust for—	1934	1935
Rober	$9,207.91	$9,859.20
Anne	9,208.23	9,787.46
Margaret	9,201.81	9,782, 17
Harriet	9,226.20	9,788.20

In 1934 and 1935 the entire net income of the trusts for Anne, Margaret and Harriet was added to the principal of the respective trusts. In 1934 and 1935 $1,391.50 and $1,882.50 of the net income of the trust for Robert was distributed to him and the balance of the net income was added to the principal of the trust (R. 29).

In 1934 the total net income of the four trusts was $37,162.91, and in 1935 the total net income of the four trusts was $39,217.03, of which amount $25,831.15 was received by the trustees during the period from January 1 to August 2, 1935 (R. 29).

Taxpayer's net income (not including any income of the four trusts) was $117,153.17 in 1934 and $175,794.47 in 1935. At the time of the creation of the four trusts, taxpayer's net worth was approximately $3,000,000 and the property which he transferred to the trusts had a value of approximately $600,000 (R. 29–30).

In determining the deficiencies for 1934 and 1935, the Commissioner included in the taxpayer's income the net income of each of the trusts for 1934 and the period from January 1, 1935, to August 2, 1935. The Board of Tax Appeals sustained the Commissioner's action but the court below reversed the decision of the Board as to all of the trust income except the amounts distributed to Robert Stuart.

This is a companion case to *Helvering* v. *John Stuart, supra,* where, as more fully shown by the

record therein, to which reference is here made, the grantor established three trusts, one for each of his three children, naming himself, his wife, and his brother (this grantor) as trustees. The corpus of each trust consisted of shares of stock in the Quaker Oats Company of which both brothers were high officers. The trusts contained substantially the same provisions as the instant ones and also empowered the grantor's wife and brother to make any changes in those provisions. On August 3, 1935, the wife and brother relinquished that power.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the trust income was not taxable to the grantor under Sections 166 or 167 of the Revenue Act of 1934.

(2) In holding that only the amounts of income distributed to Robert Stuart were taxable to the grantor under Section 22 (a) of the Revenue Act of 1934 and in not holding that all of the trust income here involved was taxable to the grantor under that section.

(3) In reversing the decision of the Board of Tax Appeals.

ARGUMENT

I

THE ENTIRE NET INCOME OF THE TRUSTS IS TAXABLE TO THE GRANTOR UNDER SECTIONS 166, 167 AND 22 (A) OF THE REVENUE ACT OF 1934

This case presents the same questions as those in the *John Stuart* case, *supra,* and reference is here made to our brief in that case which sets forth in full the arguments in support of the Commissioner's position both there and here.

II

IN ANY EVENT, THE UNDISTRIBUTED TRUST INCOME IS TAXABLE TO THE GRANTOR BECAUSE IT COULD HAVE BEEN USED FOR THE SUPPORT OF HIS MINOR CHILDREN

Since all of the taxpayer's children were minors during the taxable years (R. 14, 27), a further question, not presented in the John Stuart case, arises here. By Paragraph Fourth of each trust indenture, the grantor, his wife and his brother, as trustees, were empowered to pay over to the child-beneficiary or apply so much of the net income for his education, support and maintenance as they should deem advisable. The question is whether the grantor is taxable upon trust income which was available for support of the children even though it was not so applied. The court below answered this question in the negative, taking

the view that the grantor was accountable only for the amounts of income actually distributed to one of the children, Robert. We submit that in the circumstances of this case the grantor is taxable upon all of the trust income which could have been used for the education, support and maintenance of the children, under the authority of both Section 167 and Section 22 (a).

There is no question that the grantor was legally obligated to support his minor children during the taxable years, and, indeed, the court below so conceded in holding him taxable under *Douglas* v. *Willcuts,* 296 U. S. 1, on the income distributed to Robert. See also *Helvering* v. *Schweitzer,* 296 U. S. 551; *Helvering* v. *Stokes,* 296 U. S. 551; *Helvering* v. *Coxey,* 297 U. S. 694; *Commissioner* v. *Grosvenor,* 85 F. (2d) 2 (C. C. A. 2). Those cases all hold and it is now settled that the grantor of a trust is taxable upon income therefrom which is applied pursuant to the trust terms in satisfaction of his legal obligations. *Helvering* v. *Fitch,* 309 U. S. 149; *Helvering* v. *Leonard,* 310 U. S. 80.

The basis on which the grantor is taxable on income of a trust used to satisfy his legal obligations was explained as follows in *Douglas* v. *Willcuts,* 296 U. S. 1, 9:

> We have held that income was received by a taxpayer, when, pursuant to a contract, a debt or other obligation was discharged

> by another for his benefit. The transaction was regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor * * *. The creation of a trust by the taxpayer as the channel for the application of the income to the discharge of his obligation leaves the nature of the transaction unaltered. * * * In the present case, the net income of the trust fund, which was paid to the wife under the decree, stands substantially on the same footing as though he had received the income personally and had been required by the decree to make the payment directly.

Since one whose legal obligation is paid by a distribution of income from a trust is treated for income-tax purposes as having received that income himself, it follows that one whose legal obligation could have been paid by the use of income of a trust must be treated for income-tax purposes as if that income could have been distributed to him directly.

Consequently, the taxpayer herein was taxable under Section 167 (a) (2), which taxes the grantor "Where any part of the income of a trust * * * may in the discretion, etc. * * * be distributed to the grantor" because the taxpayer could, jointly with two other trustees not having a substantial adverse interest, have distributed the entire income of the trusts for the support and maintenance of his minor children. As we have seen,

such a distribution would for tax purposes have been tantamount to a distribution directly to the taxpayer.

In our brief in *Helvering* v. *John Stuart*, No. 48, we have shown that the grantor's wife and brother did not have a substantial adverse interest in the trust. That showing is applicable here and justifies the conclusion that the wife and brother as trustees did not have a substantial adverse interest to the use of the income for the support and maintenance of the grantor's minor children. Moreover, it is difficult to imagine that a mother would consider herself adverse to a distribution of money for support of her children. Cf. *Commissioner* v. *Caspersen*, 119 F. (2d) 94 (C. C. A. 3), certiorari denied, 314 U. S. 643. And it is also difficult to imagine the brother's opposing such a distribution, particularly in view of the trusts established by that brother in which the grantor herein was trustee and donee of a general power. Thus the wife and brother are wholly without an interest adverse to the use of the trust income for the support and maintenance of the minor children, and the conditions of the statute upon which taxability to the grantor depends are fully met.

The taxpayer also is taxable under section 22 (a) for the reasons set forth in *Whiteley* v. *Commissioner*, 120 F. (2d) 782 (C. C. A. 3), certiorari denied, 314 U. S. 657. The power of the

grantor to use the income so as to satisfy his own legal obligations, coupled with the other controls he retained over the income and corpus of the family trust, justifies taxing him as the owner of the income who has merely made a gift of it. Compare *Helvering* v. *Horst*, 311 U. S. 112.

In our brief in *Hormel* v. *Helvering*, 312 U. S. 552, we raised a similar point [1] which was not considered by the Court in its opinion, for it disposed of the case upon the broader ground that the grantor remained in substance the owner of the trust properties under the rule in *Helvering* v. *Clifford*, 309 U. S. 331.

CONCLUSION

The judgment of the court below should be reversed.

---

[1] Although there is a ruling (G. C. M. 18972, 1937-2 Cum. Bull. 231, 233) which appears to be contrary to our position, that ruling seems out of harmony with Article 167-1 of Regulations 86 which both as originally adopted and as amended (see Appendix to Commissioner's brief in *John Stuart* case) is in accord with our interpretation of the law. That ruling was precipitated by *Black* v. *Commissioner*, 36 B. T. A. 346, but since the decisions in *Pyeatt* v. *Commissioner*, 39 B. T. A. 774, and *Whiteley* v. *Commissioner*, *supra*, affirming 42 B. T. A. 402, as well as certain unpublished decisions of the Board of Tax Appeals also pointing the other way, the Treasury has been doubtful of the validity of that ruling and now wishes the Court to consider the issue in order that it may be authoritatively settled.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,
L. W. POST,
Special Assistants to the Attorney General.

VALENTINE BROOKES,
Attorney.

OCTOBER 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. ~~1055~~ 49

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

R. DOUGLAS STUART,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

GEORGE I. HAIGHT,
WILLIAM D. MCKENZIE,
HERBERT POPE,
Counsel for Respondent.

April 7, 1942.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1055.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

R. DOUGLAS STUART,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

This case is similar to *Helvering* v. *John Stuart* and what we said in our brief in that case applies equally here.

The trusts involved in this case were created by the respondent two years after his brother, John Stuart, had created the trusts involved in that case. The respondent desired to provide for his children and naturally followed, except in some particulars, the form of trust which his brother had used. Because of the similarity and in spite of the fact that the trusts were not created at or near the same time, the Board of Tax Appeals thought that each grantor controlled his brother and could by mutual agreement take back the principal of his own trusts. This would involve two breaches of trust, one in each case, since, as the Court of Appeals pointed out, neither grantor could

be given back any property in the trusts created by him without a breach of trust by his brother and his wife.

Surely neither section 166 nor any other income tax provision will be applied by this Court on the assumption that by means of a fraudulent scheme for reciprocal breaches of trust the grantors might recover the principal of trusts they had created for the benefit of others.

The only decision expressly mentioned by Petitioner in his petition differs from the present case in that it involved sole control expressly reserved by the grantor.

Respectfully submitted,

George I. Haight,
William D. McKenzie,
Herbert Pope,
Counsel for Respondent.

April 7, 1942.